

VZCZCXRO9603
RR RUEHDBU RUEHIK RUEHLN RUEHPOD RUEHSK RUEHVK RUEHYG
DE RUEHKV #0955/01 1541551
ZNR UUUUU ZZH
R 031551Z JUN 09
FM AMEMBASSY KYIV
TO RUEHC/SECSTATE WASHDC 7904
INFO RUCNCIS/CIS COLLECTIVE
RUEHZG/NATO EU COLLECTIVE

UNCLAS SECTION 01 OF 03 KYIV 000955

SIPDIS

DEPT FOR EUR/UMB, EB/ESC/IEC - GALLOGLY/WRIGHT
DOE PLEASE PASS TO LEKIMOFF, CCALIENDO

E.O. 12958: N/A

TAGS: [ENRG](#) [EPET](#) [ECON](#) [PINR](#) [PREL](#) [RU](#) [UP](#)

SUBJECT: UKRAINE: NAFTOHAZ'S FINANCIAL HOUSE OF CARDS

REF: A. KYIV 421

[1](#)B. KYIV 750

[1](#)1. (SBU) Naftohaz's ability to pay its gas bill has become a monthly guessing game since the January 2009 gas crisis. While Ukraine has managed to pay its gas bill for the first four months of the year, it will face increasing difficulties to do so through the summer as it pumps gas into underground storage facilities for use during the winter heating season. In the past Ukraine paid for gas put into storage as it was consumed. Under the January 2009 contract, however, Ukraine must now pay for all gas it takes on a monthly basis. Ukraine will likely find some way to pay for its May gas bill, but the need for short-term financing of approximately \$5 billion to pay for some 20 billion cubic meters (bcm) of gas this summer will remain.

Summer Financing Crunch

[1](#)2. (SBU) Ukraine is forecasted to purchase less gas from Gazprom in 2009 than in 2008, due largely to reduced demand from industrial consumers and increased reliance on gas Ukraine already had in storage. With a forecasted average price of less than \$250 per thousand cubic meters (tcm) in 2009, Ukraine will pay some \$7.6 billion USD if it purchases 33 bcm total during 2009. (Note. In the January 2009 supply contract, Ukraine agreed to take 40 bcm in 2009. Following the conclusion of the contract, however, Naftohaz officials asked for a revision to 33 bcm which is allowed under the contract's 80 percent take or pay provision. End note.) In 2008, Ukraine purchased 52.5 bcm at \$179.5/tcm for a total payment of \$9.4 billion.

[1](#)3. (SBU) Despite an expected lower total gas payment in 2009, Ukraine again faces difficulty in making its payments to Russia. The January 2009 gas supply contract stipulates that Ukraine must pay in full each month's delivery of gas by the seventh of the following month. Prior to the January 2009 contract, Ukraine paid for its gas as it was consumed, not as it was delivered. This allowed Naftohaz to use the revenues it collected as it sold the gas to offset the gas bill from Gazprom. Any shortfall was made up through state budget subsidies and loans. This year, however, Naftohaz is required to pay Gazprom as it takes gas. In winter months, when gas usage is high because of heating needs, Naftohaz receives more revenues and is able to make the gas payment with some financial wrangling (Ref A). In the summer, however, when Ukraine needs to pump approximately 20 bcm of gas into underground storage facilities for use during the winter heating season, it will be difficult for Ukraine to pay its monthly gas bill as its revenues drop due to lower consumer demand for gas in the summer.

[1](#)4. (SBU) When Naftohaz's financial plan was accepted by the Cabinet of Ministers in March, the government and Naftohaz boasted that Naftohaz would have a budget surplus in 2009,

which is only possible because of tax breaks and subsidies it receives (see para 7 below). However, the financial plan did not address how Naftohaz would pay for the 20 bcm of gas it needs to pump into storage during the summer months. In April Naftohaz paid \$621 million for 2.3 bcm of gas from Russia and pumped 800 million cubic meters of that total into storage. In May Naftohaz purchased some \$650 million or 2.4 bcm of gas. Kyiv-based Center for Energy Research estimates that Naftohaz in May collected approximately \$350 million from the domestic sale of gas, leaving a \$300 million shortfall for the May payment to Gazprom due June 7.

Possible Financing Methods

15. (SBU) As long as Ukraine has sufficient foreign currency reserves, it can resort to the financing scheme it used earlier this year and late last year to make its payments to Gazprom (Ref A). Under this mechanism, the National Bank of Ukraine (NBU) loans hryvnia funds to state-owned banks who in turn loan money to Naftohaz. Naftohaz then uses the liquidity from the state banks to purchase dollars from the NBU to pay Gazprom. Most experts forecast that Ukraine will have a balanced current account this year allowing it to generate enough foreign reserves to cover all imports, including gas purchases from Russia. The IMF Resident Representative in Kyiv similarly told us that he is confident Ukraine will have enough reserves to cover gas purchases. As long as foreign currency reserves are not depleted too quickly, Naftohaz should be able to use this method to pay its monthly gas bill.

KYIV 00000955 002 OF 003

16. (SBU) The Ukrainian government has also provided Naftohaz with tax breaks and an increase to its budget subsidy for 2009. The 2009 budget already contains a 1.6 billion hryvnia (UAH) subsidy (approximately \$210.5 million) to Naftohaz which covers the difference between the price Naftohaz pays Gazprom for gas and the price at which it sells that gas to the population and local heating companies. Additionally, the Cabinet of Ministers on April 2 passed a resolution that gave an additional UAH 3.5 billion (\$460.5 million) to Naftohaz to cover Naftohaz's tax debt for the last quarter of 2008. Finally, the parliament has also considered, but has yet to take action on, amendments to the budget which include an increase of Naftohaz's budget subsidy to UAH 7.7 billion (approximately \$1 billion). On May 13 the Cabinet of Ministers agreed to postpone for five years tax payments Naftohaz owes on the 11 bcm of gas that it took from RosUkrEnergo as part of the January 2009 transit contract signed with Gazprom, some UAH 6.7 billion UAH.

17. (SBU) Ukraine has also raised the possibility of paying for the winter heating gas being placed in storage by forgoing future transit fees (Ref B). Russia has already allowed Ukraine to pay for a portion of gas purchased in April through an advance of transit fees. Recent statements from Prime Minister Putin, however, indicate that Russia is unwilling to advance more transit fees to Ukraine having already advanced all expected transit fees for 2009 to Naftohaz. There are conflicting statements as to how much Russia advanced to Ukraine for future transit. Russian Deputy Prime Minister Igor Sechin stated on May 29 that Gazprom has already paid Ukraine \$2.15 billion for transit fees through February 2010. Party of Regions Deputy Yuriy Boyko stated that Gazprom has advanced transit fees through May 2010. President Yushchenko has also spoken forcefully against advanced transit payments, saying it could endanger Ukraine's gas transit system by yielding some control of it to Russia.

19. (SBU) Local press reports have also speculated that Ukraine would seek financing from the European Union or other donors to cover the \$5 billion gas payment it faces this summer. The energy expert at the EC Mission in Kyiv, though,

told us that by the end of May the Ukrainians had not requested any financing assistance from the EU. EU officials in Brussels, meanwhile, have stood by their call for greater transparency in Naftohaz before any financing agreements could be reached. Russian officials have stated publically that Ukraine's request for a \$5 billion loan was denied. The prospects for any foreign commercial financing seem non-existent for Naftohaz at this time. Following Moody's downgrade of Naftohaz from B1 to B2 on May 15, the credit rating agency again downgraded Naftohaz at the end of May to Caal with a negative outlook.

Possible Impacts of Missed Payment

¶10. (SBU) If Naftohaz fails to pay on time and in full, Gazprom could force it to prepay each month's expected gas bill. Russian officials, most recently Gazprom's CEO Alexei Miller, have repeatedly stated that Gazprom will enforce the prepayment clause of the January 2009 contract if Ukraine misses the June 7 payment. Naftohaz will be under even greater strain if it is forced to prepay, as it currently struggles to make each month's gas payment after having collected revenues for the gas it sells. Under a prepayment scenario, Naftohaz would need to seek even more financing--either from the state or from donors.

¶11. (SBU) While Russia could turn off gas supplies to Ukraine if it fails to make a payment, the near term impact on the rest of Europe would be negligible given the lower demand for gas in the summer months. However, if Ukraine does not manage to fill its underground storage facilities during the summer months, Ukraine and Europe could face gas shortages come winter when demand is higher. The aging infrastructure of Ukraine's gas transit system limits the rate at which the underground storage facilities can be filled and how much gas can be transited.

Comment

¶12. (SBU) The coming summer months will be the first real test of Ukraine's ability to meet the stringent payment provisions of the January 2009 gas supply contract. With low summer revenues, Naftohaz is forced to look for outside financing to meet its obligations to Gazprom. However, Ukraine should have sufficient foreign currency reserves to

KYIV 00000955 003 OF 003

cover Russian gas purchases. While Naftohaz has argued that the EU and Russia should finance the gas in storage as it benefits both European countries and Gazprom to have Ukraine store the gas, so far both the EU and Russia have been reluctant to commit to any financing. Russia's repeated warnings about Ukraine's inability to pay, meanwhile, appear to be an attempt to paint Ukraine as an unreliable transit partner to the EU and strengthen Russia's calls for alternative gas routes. End comment.
PETTIT